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UNCLAS SECTION 01 OF 02 ISTANBUL 000276

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E.O. 12958: N/A
TAGS: ENRG EINV ECON PREL TU
SUBJECT: ZORLU CFO OUTLINES THE GROUP'S TUPRAS PLANS

REF: A. ISTANBUL 90
¶B. ANKARA 433

¶1. Sensitive but unclassified - not for internet distribution.

¶2. (SBU) Summary: In a February 18 meeting with Econoff, Zorlu Group Chief Financial Officer Cem Koksal outlined the group's strategy for completion of the purchase of the Turkish refiner Tupras, predicting agreement with Turkey's Privatization Administration on a 60-day timeline for conclusion of the final share purchase agreement in coming days. Koksal stressed that Zorlu entered the deal on the basis of equality with its Russian partner, Tatneft (which participated in the tender through a German subsidiary--Efremov), and will contribute half of the purchase price. He dismissed questions that have been raised about the partners' ability to finance the deal, suggesting that the two companies will pay half of the 1.3 billion USD purchase price in cash and will finance the remainder through a consortium of Turkish and international banks. Given existing management's ongoing 750 million USD investment program at Tupras, Koksal sees little need for the immediate injection of additional funds, though the new owners will try to speed up implementation of the program to ensure that the refinery meets E.U. standards when they come into force next year. End Summary.

¶3. (SBU) Finishing Touches: Accepting congratulations on the group's success in the Tupras tender, Koksal noted that the timeline for completing the share purchase agreement between the winning bidders and the Turkish Privatization Administration should be finalized in coming days. He noted that Zorlu's Russian partner Tatneft had initially wanted a 90 day term, but would compromise on 60 days (in place of the usual 45). He stressed that although Zorlu entered the process on the basis of full equality with Tatneft, and will split the purchase price 50-50, initially it will only have a minority 49 percent stake. He ascribed this complication to the fact that Tatneft's initial bid envisioned a 51 percent share for Tatneft, and that this cannot be changed until the process is completed. Any attempt to do so, he noted, would spark negative publicity that the group wants to avoid, particularly given the complaints about the process already voiced by the losing Cukorova Group. It might also provide ammunition for legal challenges that will be mounted by labor opponents of the sale.

¶4. (SBU) Financing: Koksal said that Zorlu and Tatneft will each put in 325 million in cash for an initial 650 million USD downpayment, and will finance the rest from a consortium of Turkish and international banks. The partners intend to pay the entire amount up front, he indicated, to "put to rest" rumors that the companies may not be able to meet their obligations, though he emphasized that they did not expect to receive a discount in the purchase price from the PA for doing so. He noted that the financing on the installment plan offered by the PA, at 7 percent, was too high, and that since the group would need to finance the remainder in any case, it is better to do so in today's "bullish" markets. Koksal added that some part of Zorlu's downpayment would also be financed, though the bulk would come from contributions from various group companies. Turkish banks, he said, are very interested in the deal, since they currently enjoy a strong equity base with excess liquidity. They are also attracted by the prospect of regular business from Tupras, given that its banking activities will be channeled through financing banks. Koksal noted that the group's financing focus is currently on large Turkish banks like Garanti and Isbank; the group's Denizbank will not participate to avoid

any appearance of connected lending, and they would prefer to avoid using industry leader Akbank, with which the group does not have an existing relationship.

¶5. (SBU) Tatneft: Koksal expressed little concern about the various legal challenges Zorlu's Russian partner faces, suggesting that such legal processes as shareholder consultation were required only if the company had participated directly in the tender. Instead, by using its German subsidiary, Efremov, it had effectively shielded itself from these legal requirements. Once the deal is completed, however, it would assume direct responsibility for it. He hailed the project, suggesting that it represents Russia's biggest overseas investment and is equal in scope to the Blue Stream project. He added that Tatneft's interest in Tupras stems in part from recent delays on the Bosporus, in that Tupras shipments are able to "jump the queue" and sail directly to the company's Izmit refinery. The ability to avoid these delays was a powerful incentive for Tatneft, as is the fact that as part of the purchase the partners agreed that assuming that pricing and quality are equal, Tupras will first purchase oil from Tatneft. (Earlier, managers at Ditas, Tupras' tanker company, had told us that the company only sources 2.5 million tons of oil each year from Russia, with the bulk of its supplies coming from Iran and Syria.)

¶6. (SBU) Labor woes: Koksal conceded that the purchase will confront challenges from organized labor, which he attributed more to the fear of the petroleum workers union (Petrol-Is) that it will continue to lose power and influence than to concern about job losses. In fact, Koksal suggested, employment at Tupras is not far from world standards, and exceeds that level by only 10 percent or so. Hence he does not anticipate major layoffs, believing instead that the labor force can be thinned mostly through attrition as workers retire. He added that Zorlu had expected the legal challenges, but does not expect them to be successful.

¶7. (SBU) Investment: Koksal stressed that Zorlu and Tatneft see little need for large immediate investments in their new acquisition. A major capital investment program has been underway since 2001, he noted, and will total 750 million USD by 2006. The bulk of this total (two-thirds) is dedicated to bringing Tupras' diesel production into line with EU standards. This is key to Tupras' future, he argued, since under Turkey's new petroleum law, from next year distributors will be able to source 100 percent of their purchases from overseas, rather than the current 40 percent. Implementation of EU standards, however, will create a natural entry barrier which will keep out cheaper low quality products, while Turkey will retain its competitive advantage against its European rivals. He added that overall refineries in Izmit and Izmir are up to world standards, while the Baku-Tbilisi-Ceyhan pipeline will bring new raw materials to the Kirikkale refinery. The major question is Tupras' oldest refinery at Batman in Turkey's southeast, which cannot be brought into compliance with EU sulphur rules. Koksal noted that the government retains a golden share in the company, and the military may desire to keep this site operational for strategic reasons. Koksal added that the new partners also have serious questions about Tupras' plans for a new refinery in Izmit, believing that it may lead to excess capacity and would be a mistake, given that investments in refineries typically trade at half their "book" value. He noted that the partners' consultants have told them that Tupras capacity can increase from 25-26 million tons per year to 30 million tons simply by shifting production from "black to white goods."

¶8. (SBU) Comment: Koksal is Ahmet Zorlu's key advisor on financial and other issues, and as his comments reflect has been deeply involved in the group's strategy on the Tupras acquisition. He noted too that the group is moving ahead on other fronts as well, planning to increase its volume of exports of white goods to Europe from 1.5 billion USD to 2.3 billion. End Comment.
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